Social Security Private Accounts: A Risky Proposition?

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Private accounts have been mentioned as one part of the resolution of the difficulties facing Social Security over the coming years. The trustees of the Social Security Trust Funds project that Social Security will become insolvent in 2041 (Board of Trustees 2005). Because Social Security is a government program, the meaning of *solvency* here is tricky—after all, the federal government is not projected to be insolvent in any meaning of the word. Isn't 2041 a long time from now? Why not wait for a while before making a change to such an important government program?

The purpose of this article is to provide an introduction to Social Security private accounts—what they can and cannot do for those who choose to use them and for looming Social Security deficits. The discussion will also explore why it is expedient to introduce these accounts now to deal with a problem that will not become acute for decades.

Several different precise proposals about private accounts for Social Security have been put forward. These proposals vary in terms of the amounts that can be contributed, permissible investments, and the way funds can be used. The article discusses a general version of these private accounts and their implications for private individuals and points out the implications for those who choose them.

How Would Private Accounts Operate?

Basic principles of private accounts. The common element in all proposals for private accounts is that people can take part of their Social Security taxes and place them in accounts in which they have personal ownership rights. In most respects, these accounts would be no different than current individual retirement accounts (IRAs) or defined-contribution retirement plans at many places of employment. While many people in the United States have such accounts, not all do. Roughly 40 percent of all families did not have such accounts in 2001 (Aizcorbe, Kennickell, and Moore 2003). Such accounts would make accumulating assets possible for many families

that otherwise would not have the opportunity to do so. The funds in a private account would be the property of the person whose payroll deductions contributed to the account. This ownership may sound like a small thing, but it is not. In fact, it has far-reaching consequences.

The value of a private account in the future would be determined by the returns earned on the assets in the account, with the owner accruing any gains or losses. In other words, the accounts have an element of risk—a risk that the account might not have enough funds to pay for planned expenditures. While the existence of risk may seem like a difference between Social Security and private accounts, it is not. All plans for the future involve risk, and the further out the plans, the greater the risk. Private accounts and Social Security are no exception to that rule. Private accounts just have different risks than Social Security, a point elaborated later.

It is incorrect to suggest that Social Security has no risks. The risks are different than those with a private account, but the risks are real.

Funds in an IRA can be withdrawn before retirement, but no existing proposal gives participants any right to withdraw funds from a Social Security private account before retirement. Private accounts can be viewed as forced saving—the government forces people to save for their retirement whether they want to or not. Allowing private account owners to withdraw funds before retirement is inconsistent with this forced saving for retirement. Owners of private accounts would not be allowed to withdraw funds, no matter how pressing the possible current use of the funds—whether to finance a vacation, to buy a house, to pay for a child's education, or to pay medical bills. The funds would be dedicated to financing retirement, even if it is the furthest thing from the owner's mind.

Some proposals require that owners of private accounts use the funds to purchase an annuity at a certain age, further restricting the use of private accounts. In contrast, IRAs and 401(k)s can be taken in a lump sum or they can be annuitized. When an asset is annuitized, the owner of the asset trades it for a set of payments over his or her remaining life. These payments may be constant in dollar terms, or they may increase or decrease over time, but the seller of annuities guarantees a stream of payments in exchange for the asset. The annuity provides these payments over the owner's remaining life, no matter how short or long that period may be. Requiring annuitization by everyone by a certain age would be disadvantageous to some people, most obviously those who are mortally ill or in poor health, but it benefits those who will live longer and does guarantee that owners of private accounts cannot outlive the payments from their account.[1] Such a restriction is an aspect of forced saving for retirement.

Just as an IRA account can be willed to heirs at death, any amount in a private account could be given to heirs. The owner owns the funds in the private account, and they can be disposed of as the owner sees fit. The funds can be used to provide for a spouse or children or can be given to charity.

Social Security. Private accounts are different from Social Security in several ways. First, the Supreme Court has ruled that participants in Social Security do not have ownership rights such as those held by a purchaser of an annuity or a participant in a retirement plan.[2] Congress can change benefits, and the change, as long as it is otherwise legal, is not restricted by benefits previously provided in the law. If Congress were to lower Social Security payments by 20 percent today, no one would have recourse through the courts. People's recourse would be through the ballot box.

In fact, Social Security benefits have been reduced in the past (Social Security Administration 2005b, 2005c). The benefit formula was scaled back in 1977. Legislative changes in 1983 made Social Security benefits taxable for some recipients and are gradually increasing the age for full-benefits eligibility from sixty-five to sixty-seven.[3] In 1993 the taxable part of Social Security benefits was increased from 50 percent to as much as 85 percent of benefits depending on the recipient's other income.

Social Security Administration statements sent out in 2005, which estimate future benefits, accurately state that

> Estimated benefits are based on current law. Congress has made changes in the law in the past and can do so at any time. The law governing benefit amounts may change because, by 2042, the payroll taxes collected will be enough to pay only about 73 percent of scheduled benefits.

Just as with the hypothetical 20 percent decrease in benefits today, this 27 percent decrease in benefits in 2042 is extremely unlikely to happen as a large decrease in benefits in one year. Changes to prevent this large benefit decrease in one year will happen. What type of changes will occur and whether they will happen in 2005 or 2042 or sometime in between are unpredictable. Hence, it is incorrect to suggest that Social Security has no risks. The risks are different than those with a private account, but the risks are real.

Because Social Security retirement payments affect so many people, it is natural for discussions of Social Security reforms to focus chiefly on retirement benefits. (In this article, "Social Security," unless otherwise qualified, refers to this Old Age and Survivors Insurance benefit.) The Social Security Administration, though, actually has a set of programs including disability insurance. Medicare is another very large government program, which provides medical care for those covered by the program.[4]

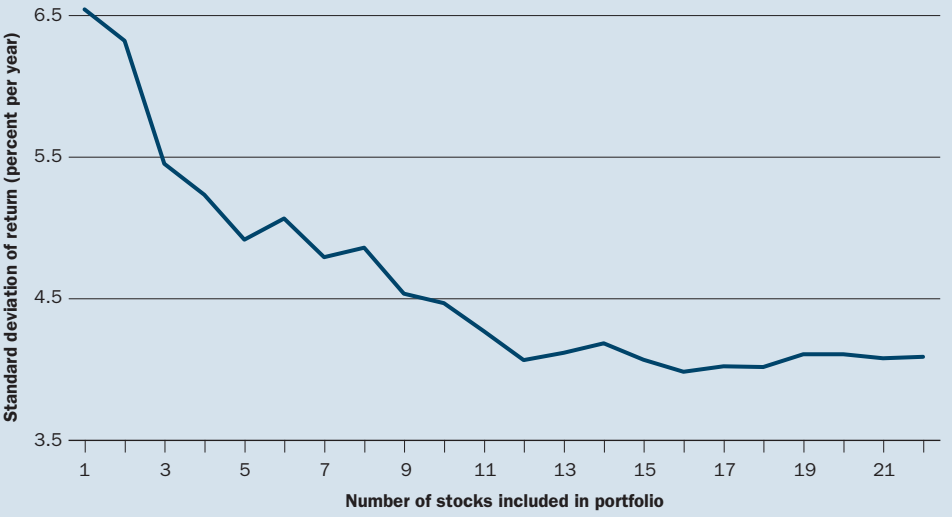
Any person paying into the Social Security system runs the risk of never receiving any benefits. If a person lives until retirement age, he or she can begin collecting Social Security retirement benefits, and if that person dies while receiving retirement payments, Social Security generally pays a continuation of retirement benefits to a spouse. Social Security will also pay benefits to surviving minor children until they are eighteen. Some survivors are also eligible for a death benefit—currently $255. But for a person who passes away before reaching retirement age without a spouse or minor children, Social Security benefits received are zero.

Risk and Return: Investments of Private Account Balances

Most proposals for private accounts limit the range of assets that can be held in a private account but permit owners to determine their investments based on their own

1. This restriction solves a so-called adverse selection problem that some commentators worry about.
2. This ruling was made in *Flemming v. Nestor* in 1960. (Some background and the decision are provided by the Social Security Administration 2005a.) In this particular case, a foreigner who was a resident in the United States and paid Social Security taxes for nineteen years was deported because he was a Communist. Congress changed the law to deny Social Security benefits to such people who were otherwise eligible for Social Security. Mr. Flemming sued and lost on his claim for Social Security benefits.
3. The Treasury transfers the receipts of the income tax on Social Security benefits to the Social Security Administration, which makes this tax quite effectively a reduction in benefits for those with sources of income besides Social Security.
4. This program has its own set of problems, which are not discussed in this article.

Figure 1
The Variability of Portfolio Returns with the Number of Stocks in the Portfolio, 1955–2004



Note: For the 1955–2004 period, the variability of the return on one stock is the variability of the return on the first common stock with *A* as the first letter in its name, and the variability of the return on two stocks is the return on a portfolio of the *A* stock plus an equal dollar holding of the first common stock with *B* as the first letter of its name; for the portfolio of three stocks, the first stock with *C* as the first letter of its name is added to the portfolio, and similarly for *D*, *E*, and so on. Because there is no stock whose name starts with *Q*, *X*, *Y*, or *Z* for 1955 to 2004, the largest portfolio in the figure includes twenty-two stocks instead of twenty-six.

Source: Center for Research in Security Prices (CRSP) (2005)

preferences about risk. Generally speaking, the more risk associated with an asset, the higher the expected return. Some people have very low tolerance for risk, but others are quite willing to give up some predictability of the asset's ultimate payoff in exchange for a higher expected payoff.

A typical list of assets that can be held in a private account is similar to the assets held in the Thrift Savings Plan operated by the federal government for civilian employees and members of the armed forces and in many similar private plans. Participants in the Thrift Savings Plan can hold their assets in a government securities investment fund, a fixed income index investment fund, a common stock index investment fund, a small capitalization stock index investment fund, and an international stock index investment fund.[5] How do such assets differ, and what factors are likely to determine people's choices of assets?

It is important to note that individual stocks are not included in this list of assets. Individual stocks have substantial idiosyncratic risk that is associated with the individual firm's fortunes and largely unrelated to other developments. All of these funds are portfolios of assets, which diversify away much of the risk in individual securities. Precisely because idiosyncratic risk is specific to a particular firm, when the value of one firm goes down, another may go up, go down, or stay the same. The idiosyncratic risk of individual firms averages out across firms.

Figure 1 shows the variability of the return from holding individual common stocks and how this variability falls as more stocks are held. Variability of return is a common measure of risk. Risk means the probability of a loss, but if bad outcomes are offset by good outcomes, stocks with returns that vary more down also vary more up. Hence, risk can be measured by variability up and down, which the standard devi-

ation in Figure 1 reflects.[6] The stocks shown in Figure 1 were chosen quite arbitrarily; they were picked based on the alphabet and the company's name.[7] As the figure shows, in general, holding more stocks lowers the risk—measured by the variability of the annual return over fifty years—of the holdings of stock.

In many ways, this finding just reflects the old adage, "Don't put all your eggs in one basket." In the context of stocks, the adage translates into "Don't put all your retirement in one stock." Portfolios of a large number of stocks diversify away much of the idiosyncratic risk. If the price of General Motors stock falls today, it will have little effect on a portfolio of hundreds of stocks.

All plans for the future involve risk, and the further out the plans, the greater the risk. Private accounts and Social Security are no exception to that rule.

Portfolios of assets still have risk. Besides idiosyncratic risk, individual stocks have common risks such as recessionary risk, which remains in a portfolio of stocks. Recessions are associated with decreases in stock prices (Dwyer and Robotti 2004). Individual stocks respond differently to recessions because recessions affect some firms more than others, and holding a portfolio of stocks can reduce the effect of a recession compared to holding a stock highly sensitive to recessions. Nonetheless, no amount of averaging of individual stocks' recession risk makes that risk go away. Hence, even portfolios of stocks—and portfolios of other assets—have risk.

The annual returns on assets such as those in the federal government's Thrift Savings Plan are shown in Figure 2 for the last fifty years—1955 to 2004. The return for each portfolio is the percentage change of the value of its assets from the end of one year to the end of the next year. The portfolios include Treasury bills (which are short-term government securities), corporate bonds, common stocks, small-cap stocks, and international stocks. Treasury bills, because they have short maturities and are obligations of the federal government, are risk free in the sense that anyone holding them to maturity will get the promised payment of dollars. This return provides a benchmark for measuring the variability of returns. Corporate bonds are longer-term securities that have more risk because they are long term and because they are obligations of companies that may have difficulties and may not make the promised payments to bondholders. The common stock return is similar to that provided by some mutual funds that attempt to produce the same return as an index of overall market returns. The small-cap return shows the higher return, at least over this period, from holding smaller firms' stocks and the higher variability of the return from holding only such stocks. Even though similar data are available only since 1970, Figure 2 also shows the return on a portfolio of international stocks. These stocks, while not necessarily lower risk than U.S. stocks, can be used to diversify away some of the risk resulting from U.S.-specific events.

All of the assets included in Figure 2 are returns on financial assets—pieces of paper that are claims to future payment. These assets do not represent direct

5. Information about the Thrift Savings Plan is from its Web site, www.tsp.gov.
6. The standard deviation of a return is $s = [\Sigma(r_t - \bar{r})^2 / (T-1)]^{1/2}$, where r_t is the return in any individual year, T is the number of years for which returns are available, and $\bar{r}$ is the average return over T years.
7. The choice of stocks available in 1955 is not random because the stocks must exist for the whole period, meaning that the firm cannot have gone out of business or been purchased by another firm. This nonrandom choice does not affect the point about the variability of return as the number of stocks held increases. The returns are from the Center for Research in Security Prices (CRSP) database.

Figure 2
Returns from Portfolios of Financial Assets, Percent per Year, 1955–2004

Source: Ibbotson Associates (2005)

ownership of real assets, such as a house owned by a household or a factory owned by a firm. Part of the return from holding a real asset is the capital gain—the increase in price. The capital gain on real assets is positively correlated with the inflation rate for goods and services. The remaining part after inflation, which is called the real return, is the part represented by the value of living in the house or using the factory and represents an asset's return adjusted for inflation. Financial assets have a related real return: the nominal return adjusted for inflation. Figure 2 includes the inflation rate, which is

related to the capital gain from holding real assets and can be subtracted from the nominal returns to get an approximate measure of the real return from holding these financial assets. Inflation, while it has varied over the last fifty years, has not varied nearly as much as the returns on these financial assets other than Treasury bills.

The variation of annual returns is what might be expected. Treasury bills—the short-term government security—show the least variation. The portfolio of corporate bonds shows more variation but not as much as the portfolios of stocks. The stock portfolios show by far the most variation. Small firms have more variable returns than large firms. While diversifying away the idiosyncratic risk of individual securities lowers risk, there still is substantial variation in the returns on stock.

Table
Risk and Return of Financial Assets, 1955–2004

	Average return (% per year)	Variability of return (% per year)[a]
Treasury bills	5.28	2.89
Corporate bonds	6.80	10.18
Common stocks	10.94	17.66
Small-cap stocks	14.56	25.64
International stocks	20.70	56.21

[a] The variability of return is measured by the standard deviation of the return.

Source: Ibbotson Associates (2005)

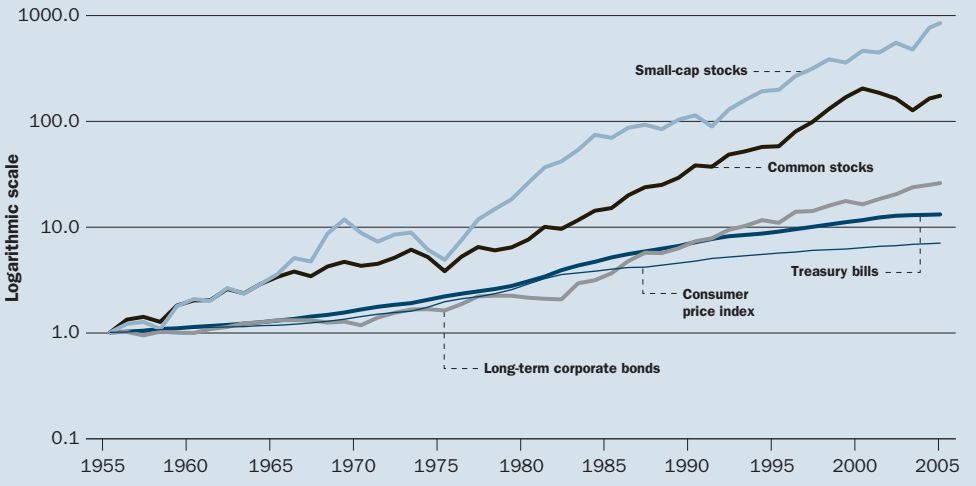
The table shows that higher risk is associated with higher average return. The table shows the average return from holding each of these assets and the variability of the return. Treasury bills have the lowest average return as well as the lowest value of the measure of variability of return—the standard deviation. There is a clear relationship between risk and return.

In terms of retirement accounts, a different and more informative view of the risk and return from holding an asset is provided by the cumulative value from an investment. One way of seeing this is in terms of a graph showing what would have happened over the past fifty years to an investment of a dollar. Figure 3 shows the cumulative value from investments in these assets other than the international stock and the cumulative value for inflation. The average return in the table for holding stock—12.3 percent—is twice the average return for Treasury bills—5.3 percent—but the cumulative value for holding stock is ten times higher than for Treasury bills. A dollar invested in Treasury bills without any money taken out for fifty years becomes $12.71 in 2004. That same dollar invested in stock becomes $134.62, more than ten times more.

In at least one way, these nominal values are misleading. It is true that $1 put into Treasury bills in 1955 would provide $12.71 in 2004. On the other hand, inflation over this fifty years means that $12.71 in 2004 would not buy nearly as much as $12.71 in 1955. In fact, $12.71 in 2004 would buy only as much as $1.87 in 1955 because prices were 6.8 times higher in 2004 than in 1955. Most of the increase in value resulting from investing in Treasury bills merely reflects inflation. The cumulative value of the investment in stocks also buys less because of inflation, but the $134.62 received after fifty years will buy as much as $19.77 in terms of 1955 prices, far more than the $1.87 from investing in Treasury bills.

What may seem like small differences in return become large differences over time. At the end of a year, a dollar invested in Treasury bills that earned the average return would be worth $1.053 while the same dollar invested in a portfolio of stocks would be worth $1.123. At the end of two years, the cumulative values with no money taken out are $1.11 and $1.26, still not much different. At the end of five years, the cumulative values are $1.29 and $1.79. At the end of ten years, the cumulative values are $1.68 and $3.19. The higher average return on stock compounds—the higher return earns a higher return earns a higher return—and what seem like small differences over a short period become large differences over long periods.

Figure 3
Cumulative Values from Portfolios of Financial Assets, 1955–2004



Source: Ibbotson Associates (2005)

These cumulative values are based on the average return, which is much like the average number of people in a family. No one gets the average return on these investments every year, any more than any family in the United States has the average number of people—3.13 people in 2003 (U.S. Census Bureau 2004, 52). Stocks in the United States have generated higher cumulative values over time, but there is substantial variability in the return in individual years. That said, over time, those who have invested in stock for a substantial period of time have in fact been rewarded for bearing this risk by higher returns, which result in higher cumulative values. The idiosyncratic variation in particular years becomes less important over longer periods (Siegel 2002).

Common advice concerning saving for retirement is that someone far from retirement should invest more in stocks because a few bad years are likely to be balanced with some other good years. This advice appears to be correct because much of a young person's wealth really is not financial; his wealth is based on future earnings. For a person close to retirement, his or her future earnings are for a shorter period, and a big decrease in stock prices in any one year can have a bigger effect on his or her retirement income (Jagannathan and Kocherlakota 1996).

This common advice is reflected in some current mutual funds—called life cycle funds—in which more assets are invested in bonds and less in stocks as a person gets older. Bonds have less variable returns than stocks, and dramatic declines in value are less likely in any individual year. On the other hand, it is worth noting that only long-term bonds fall below the cumulative value for inflation in Figure 3, which indicates that bonds have their own risks. There is risk everywhere.

Social Security Deficits and Debt

If private accounts have these risks, what problems are private accounts supposed to solve? Can Social Security have any risk? In short, the answer is "Yes, Social Security has a different kind of risk than financial assets, but it has risk." Why?

The program commonly called Social Security is more formally called Old Age, Survivors, and Disability Insurance (OASDI), which is administered by the Social Security Administration. This program pays benefits to people if they have paid in sufficient premiums for a sufficient length of time and they (1) become old, (2) become a widow or widower or are a dependent of someone who passes away, or (3) become disabled. These conditions constitute three separate and quite different programs. While there are issues concerning survivors and disability insurance, these issues are dwarfed by the problems confronting the old-age part of OASDI, which I will call Social Security consistent with common use of the term. Medicare has a separate fund and has its own set of substantial problems.[8]

If the federal government does not lower spending or raise taxes, it will issue more debt to the public instead of issuing debt to the Social Security Administration.

Social Security has its own risk because there is no doubt that the current level of tax rates and benefit rates will change. This inevitability sometimes is pointed out by saying that Social Security will become insolvent in the future. This statement is not technically correct because the federal government is not legally obligated to pay any particular level of Social Security benefits, and, hence, benefits can be reduced without legal consequences such as bankruptcy for the government or anything less drastic. The Supreme Court has ruled that Social Security recipients have no standing to sue the federal government to overturn a congressional law denying Social Security payments based on otherwise constitutional criteria (Social Security Administration 2005a).

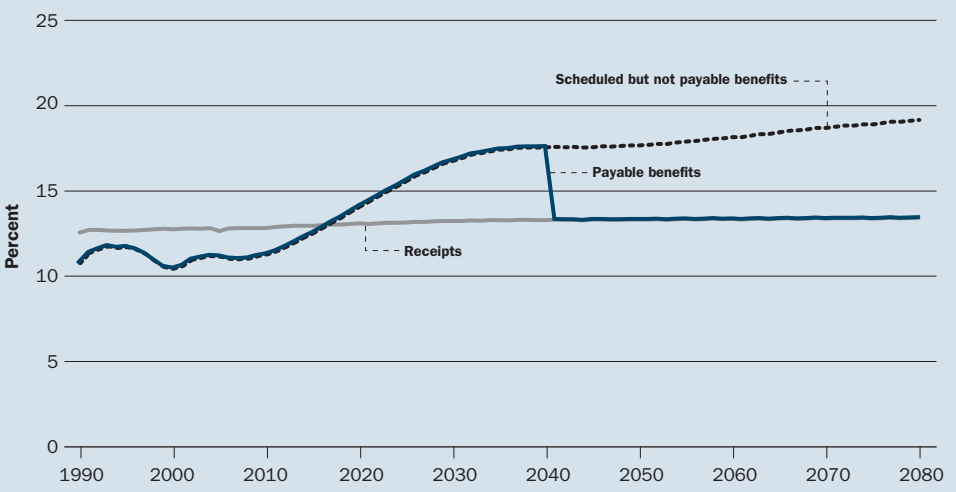
Given these technicalities, what do people mean when they say that Social Security is insolvent or is expected to become insolvent? Social Security's revenue in 2004 of $658 billion was 31 percent greater than its expenditure of $502 billion (Board of Trustees 2005, Table II.B1, p. 4). A surplus of $156 billion hardly sounds like an insolvent program. Furthermore, the Social Security Trust Fund's positive balance at the end of 2004 is $1.687 billion, which doesn't sound bad either. To get an idea of the real problem, Figure 4 presents revenue and benefits for 1990 to 2080. Prospective Social Security payments under current law are indicated by the line "Payable benefits."

Why does a large decrease in payable benefits occur in 2041? To understand this decrease, it is necessary to understand some details about Social Security's funding and current legal arrangements. Social Security's total receipts as a percent of taxable payroll are indicated by the line labeled "Receipts." Social Security currently is running a surplus, taking in more than it pays out. This surplus is indicated in Figure 4 by the greater value of receipts than payable benefits for 2005. This situation is projected to continue until 2017, at which time Social Security will start paying out more than it takes in. This deficit is shown in the figure by the excess of payable benefits over receipts for 2017 to 2041. There is a Social Security Trust Fund, which is the value of accumulated prior surpluses and interest and gives Social Security the right to receive funds from the Treasury. Funds from these accumulated surpluses and interest will be exhausted in 2041, at which time Social Security is required by law to match receipts and expenditures—hence, the big decrease in payable benefits in 2041 and later years.

Figure 4 shows the benefits implied by current law but not payable, which continue to increase as a fraction of taxable payroll with the projected aging of the population.

8. These problems are not dwarfed by the old-age part of OASDI (Board of Trustees 2005).

Figure 4
Social Security Receipts and Benefits as a Percent of Taxable Payroll, 1990–2080



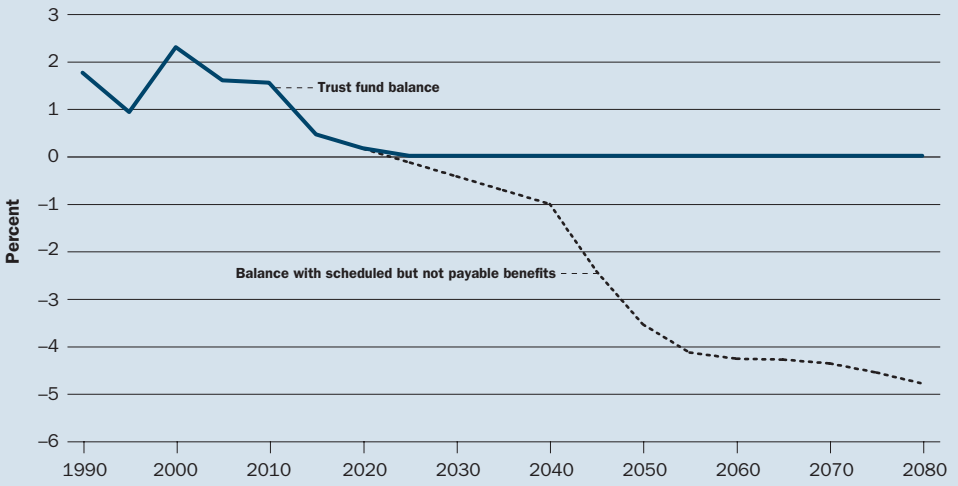
Source: Social Security Administration (2005d)

The figure ends with 2080 because Social Security projections extend out only seventy-five years. The graph shows the intermediate forecast from the Social Security trustees (Board of Trustees 2005).[9] These figures are based on Social Security collecting taxes under current law and paying benefits under current law. Assumptions about the future can affect the date at which deficits begin and their size, but only extremely optimistic assumptions change the overall pattern in the graph. Social Security is running a surplus now and almost surely will run a deficit in the future.

The value of the Social Security Trust Fund is implied by the projected deficits and surpluses each year. When Social Security has a surplus, including interest received on the trust fund, the trust fund increases; when Social Security has a deficit, the trust fund decreases. Figure 5 shows the implied value of the trust fund for 1990 to 2080. The change in the trust fund each year equals the surplus plus interest on the trust fund; when the surplus is positive, the trust fund increases; when the surplus is negative, the trust fund decreases. As Figure 5 shows, the projected trust fund hits zero in 2041 and stays there. This path is very unlikely to happen in exactly this way. Between now and 2041, benefits, taxes, or both are likely to be changed. The federal government could raise taxes to finance the current promised benefits. It could cut benefits so that benefits equal tax revenue under current law. Alternatively, the federal government could lower benefits and raise taxes.

The Social Security Trust Fund is held in nonmarketable U.S. government securities. Even though the federal government is running a deficit overall, Social Security is running a surplus. The Treasury provides government securities to the Social Security Trust Fund in exchange for the funds raised by Social Security in excess of those necessary to pay current benefits. This fact has important implications over this seventy-five-year projection. When the trust fund starts to run deficits in 2017, the Social Security Trust Fund will return these nonmarketable securities to the Treasury in exchange for cash. The Treasury, which is not accumulating assets to redeem these securities, will have to raise the cash by either raising taxes, cutting

Figure 5
Trust Fund Balance as a Percent of Taxable Payroll, 1990–2080



Source: Social Security Administration (2005d)

other spending, issuing more debt, or some combination of the three. If the payments are financed by issuing debt, the debt issuance would be substantial. If the payments are financed by raising taxes or cutting spending, these tax increases or spending cuts would also be substantial. Even if taxes were raised enough in 2041 to finance the scheduled benefits at that time, continuing problems would remain because scheduled benefits continue to increase over the years.

Given the existence of this trust fund, it may seem odd that economists refer to Social Security as a "pay-as-you-go" program—a program that uses current taxes to pay current benefits. Are economists perhaps unaware of the trust fund? No. The trust fund is an accounting scheme used by the federal government.

The trust fund is similar to a family that has two checkbooks for their single bank account. One checkbook, perhaps savings for college, has a surplus and receives interest. The other checkbook—the main one—is overdrawn for substantially more than the savings for college; this checkbook includes transfers of additional savings and interest to the savings checkbook. Perhaps sometimes it can be useful for a family to segregate accounts to keep track of what is happening, but the real truth of the matter is that, on net, the account is overdrawn. The image of an overdrawn checking account would be overwrought for the federal government's debt. Still, the net balance is the one that matters for the family's ability to finance future spending; the same is true for the federal government.

In fact, the federal government includes Social Security in the government's overall—or unified—budget and has done so since 1969. In economic terms, it is the unified budget that matters for the government's balance sheet and overall state of balance.

9. Projections for a longer period show that any actions that take care of Social Security until 2080 leave a problem in the more distant future. In other words, the program with current tax rates and benefit payments is not sustainable.

From the viewpoint of federal government receipts and expenditures, private accounts would be quite different from Social Security. Private accounts would not be the property of the federal government. There would be no justification for including funds put into private accounts in the federal government's unified budget. This consideration suggests a related question, though.

If Social Security no longer receives the funds put into private accounts, won't this decrease in funds received reduce Social Security's revenue, raise the government's debt, and perhaps thereby make Social Security riskier? In part, yes. If private accounts are created, it is hard to imagine including funds put into those private accounts in the federal government's unified budget. Currently, the federal government is creating nonmarketable bond issues that are given to Social Security in exchange for the current Social Security surpluses. If the federal government does not lower spending or raise taxes, it will issue more debt to the public instead of issuing debt to the Social Security Administration.

A private account trades the risk of future reductions in Social Security benefits and the risk of dying before retirement for the risks associated with holding financial assets.

In another sense, the answer is no. While not a legal obligation, the Social Security Administration's revenue can be viewed as having promised future benefits associated with them. A reduction in its revenue that is associated with sufficiently large reductions in promised future benefits can reduce the long-term imbalance between Social Security revenues and benefits. How large do the reductions in benefits have to be for there to be no net effect? The reductions in benefits in exchange for current revenue merely have to reflect the initial amount put into a private account plus interest earned on the nonmarketable government debt held by the Social Security Administration. Most proposals for private accounts reduce future benefits by at least that much. In short, the creation of private accounts need not exacerbate Social Security's future problems.

In fact, creation of private accounts can reduce Social Security's future problems if the reduction in future benefits is large enough relative to the value of private accounts. The reduction in benefits need reflect only slightly more than the nonmarketable debt no longer created by the federal government and its interest. This feature can be attractive to some people because some people are likely to value a deposit in a private account more than the same funds in Social Security.

Is a person better off with a private account or with the possible benefits from Social Security? It depends. Some would find a private account preferable; some would not. Private accounts would tend to be more valuable for those who would prefer receiving the return on financial assets to the likely implicit return on Social Security taxes. In part, one risk is being traded for another. A private account trades the risk of future reductions in Social Security benefits and the risk of dying before retirement for the risks associated with holding financial assets. To the extent that the return on financial assets can be more than the implicit return on Social Security, private accounts can be more worthwhile for those with a longer time until retirement because any difference in return can compound over a longer period.

Conclusion

There is no such thing as a riskless investment. Private accounts for retirement are not riskless. The closest thing to a riskless investment is a Treasury bill, which can be held to maturity. Even for this asset, returns go up and down over the years with

interest rates, and inflation reduces the value of dollars received. Stock prices and similar assets have capital gains and losses that can be substantial. On the other hand, the higher risk of loss from holding stocks is associated with higher average returns. Cumulative values from holding stocks over long periods, such as those involved in saving for retirement, are substantially more than cumulative values from holding Treasury bills.

Social Security is not riskless either. Without some change in the law, Social Security will not pay out current scheduled benefits for the foreseeable future. Social Security benefits, taxes, or both almost surely will change. What changes will occur is uncertain, so there is risk of a reduction in benefits. This risk is not imaginary; reductions in benefits have happened in the past.

Private accounts would provide people with some assets that would diversify their retirement plans away from reliance on scheduled payments from Social Security, especially for those with relatively little in the way of likely retirement income other than Social Security.

Private accounts also would lessen the commingling of the government budget and households' savings for retirement. The decrease in revenue in the unified budget need not mean that government debt will increase when the current scheduled benefits to those paying Social Security taxes are included in government indebtedness.

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